Our business model

Through our business model, we predominantly franchise our brands and manage hotels on behalf of third-party hotel owners. As an asset-light business, we focus on growing our fee revenues and fee margins, with limited requirements for capital.

Our asset-light strategy enables us to grow our business whilst generating high returns on invested capital.

Whether we franchise or manage hotels is largely dependent on market maturity, owner preference and, in certain cases, the particular brand. For instance, in more developed markets such as the US and Europe, over 90% of IHG hotels are franchised. By contrast, in emerging markets such as Greater China, 91% of IHG hotels are managed by IHG.

Over time, we believe the Chinese market will move towards a franchised model. We successfully launched the first tailored franchised offer for Holiday Inn Express in 2016 and have since expanded this to include Holiday Inn and Crowne Plaza.

IHG’s owner proposition

We focus on ensuring our brand portfolio provides a differentiated offering for both guests and owners, and we continue to invest in building a superior owner proposition. For our owners we have developed state-of-the-art technology to drive hotel demand, be it through our mobile booking app, or our cloud-based hotel solutions. Our distribution channels (call centres and booking sites, through which hotel room rates are marketed and booked), allow hotel owners to reach potential guests at a lower cost. Over the last three years, the proportion of rooms revenue booked through IHG’s direct and indirect channels, has been steadily increasing. For guests, we ensure different brands deliver on their expectations, and we continually look to enhance our brand proposition and our IHG Rewards Club loyalty programme.

For further information on our brands see pages 10 to 13.

While our business model means that we do not employ colleagues in franchised hotels nor do we control their day-to-day operations, policies or procedures, IHG and its franchised hotels are committed to delivering a consistent brand experience, conducting business responsibly, and delivering True Hospitality. See pages 22 to 25 for more information.

How we generate revenue and deliver value

Revenue from reportable segments

Our revenue is directly linked to the revenue generated by the hotels in our system.

Franchised

576,979 rooms

Central

Revenue is principally technology fee income see page 49

Managed

253,566 rooms

Owned, leased and managed lease

5,996 rooms

Franchised hotels

From our franchised hotels we receive a fixed percentage of the room revenue following a guest staying at the hotel. This is our fee revenue. We deliver value to our hotel owners through cultivation of hotel brands, economies of scale, access to shared systems and resources, guest demand across the brand estate and centralised marketing activity to drive hotel guest bookings.

Managed hotels

From our managed hotels we generate revenue through a fixed percentage of the total hotel revenue and a proportion of the hotel’s profit. As well as the benefits we deliver through our franchise model, we drive value to our managed hotel owners by optimising the performance of their hotels.

Owned, leased and managed lease hotels

For hotels which we own or lease, we record the entire revenue and profit of the hotel in our financial statements. Our owned, leased and managed lease hotels have reduced from over 180 hotels 17 years ago, to 23 hotels at 31 December 2018.

For further information on our brands see pages 10 to 13.
IHG revenue from reportable segments and the System Fund

**System Fund**
IHG manages a System Fund on behalf of our third-party hotel owners, who pay a contribution into it. In addition, the System Fund also receives proceeds from the sale of IHG Rewards Club points. The System Fund is managed by IHG for the benefit of hotels within the IHG system, and is run at no profit or loss over the long-term. In 2018 IHG recognised $1.2 billion of revenue in the System Fund. Key elements of System Fund expenditure included marketing and sales activity, technology investments including our Guest Reservation System and our IHG Rewards Club loyalty programme.

**Total Gross Revenue**
2018: $27.4 billion. This comprises:
- Franchised hotels = total rooms revenue
- Managed hotels = total hotels revenue
- Owned, leased and managed lease hotels = total hotels revenue

(Only owned, leased and managed lease hotel revenue is directly attributed to IHG.)

**Third-party hotel owners pay:**
- **Fees to IHG in relation to the licensing of our brands and, if applicable, hotel management services.**
- **Assessments and contributions are collected by IHG for specific use within the System Fund.**

**IHG revenue from reportable segments**
2018: $1.9 billion
Revenue attributable to IHG and this comprises:
- Fee business revenue from reportable segments: in 2018, 77% of our revenue came from franchise and management fees, and central revenues:
  - Franchise fees = RevPAR x rooms x royalty rate.
  - Management fees = fee % of total hotels revenue plus % of profit.
  - Central revenue (principally technology fee income – see page 49).
- All revenue from owned, leased and managed lease hotels.

**System Fund revenues**
2018: $1.2 billion
The System Fund is not managed to a profit or loss for IHG, but for the benefit of hotels in the IHG system, and comprises:
- Assessments and contributions paid by hotels.
- Revenue recognised on consumption of IHG Rewards Club points.
(See page 49 for more information.)

**IHG reported Group revenues (excluding reimbursable revenue)**

**Profit from hotel revenues**
After operating costs of sale, our margin by business model is as follows:
- Fee business after overheads: 52.4%.
- Owned, leased and managed lease: 6.9%.
Not all of our costs can be allocated directly to revenue streams and these are shown as central infrastructure costs.

**Key elements of System Fund expenditure**
- Marketing and sales activity.
- IHG Rewards Club loyalty programme.
- Global distribution systems, such as our Guest Reservation System.
For examples of how we have deployed the System Fund in 2018 to support our strategic priorities, please see pages 20 and 21.
IHG has a progressive dividend policy which means we look to grow the dividend per ordinary share each year.

Beyond this, we look to return surplus cash to shareholders through ordinary and special dividends and share buybacks.

Our objective is to maintain an investment grade credit rating. One of the measures we use to monitor this is net debt:EBITDA and we aim for a ratio of 2.0-2.5x. The ratio at 31 December 2018 was 1.7x.

Following the adoption of IFRS 16 ‘Leases’ (see page 115), from 1 January 2019 we will aim to maintain a net debt:EBITDA ratio of 2.5-3.0x, which is equivalent to our guidance under the previous accounting standard.

Our priorities for the uses of cash are consistent with previous years and comprise of:

1. Invest in the business
Through strategic investments and our day-to-day capital expenditures we continue to drive growth.

2. Maintain sustainable growth in the ordinary dividend
IHG has a progressive dividend policy which means we look to grow the dividend per ordinary share each year.

3. Return surplus funds
In October 2018, we announced a $500m capital return to shareholders via a special dividend and share consolidation. The special dividend was paid on 29 January 2019.
**Dividend policy**
The Board constantly reviews the Group’s approach to capital allocation and seeks to maintain an efficient balance sheet and investment grade credit rating. IHG has a progressive dividend policy and excellent track record of returning funds to shareholders through ordinary and special dividends, and share buybacks, with the ordinary dividend seeing 11% CAGR since 2003. This is in addition to special returns of funds detailed on page 198.
When reviewing dividend recommendations, the Directors also take into account stakeholder interests, the long-term sustainable success of the Company and ensure that there are sufficient, distributable reserves.
For more details on our dividend policy and approach, see pages 4 and 50.

**IHG’s outlook on capital expenditure**
Capital expenditure incurred by IHG can be summarised as follows.

<table>
<thead>
<tr>
<th>Type</th>
<th>What is it?</th>
<th>Recent examples</th>
</tr>
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<tbody>
<tr>
<td>Maintenance capital expenditure, key money and selective investment to access strategic growth.</td>
<td>Maintenance capital expenditure is devoted to the maintenance of our owned, leased and managed lease hotels, which has reduced as we have become increasingly asset-light. Key money is expenditure used to access strategic opportunities, particularly in high-quality and sought-after locations when returns are financially and/or strategically attractive.</td>
<td>Examples of maintenance spend includes maintenance of our offices, systems and our owned, leased and managed lease hotels. Examples of key money include investments to secure representation for our brands in prime city locations.</td>
</tr>
<tr>
<td>Recyclable investments to drive the growth of our brands and our expansion in priority markets.</td>
<td>Recyclable investments is capital used to acquire real estate or investment through joint ventures or equity capital. This expenditure is strategic to help build brand presence. Over time, we would look to divest these investments at an appropriate time and reinvest the proceeds elsewhere across the business.</td>
<td>Examples of recent recyclable investments in prior years include our EVEN Hotel brand, where we used our capital to build three hotel properties in the US and established a joint venture in a third to showcase the brand. Over time we expect to divest our interest in these hotels.</td>
</tr>
<tr>
<td>System Fund capital investments for strategic investment to drive growth at hotel level.</td>
<td>The development of tools and systems that hotels use to drive performance. This is charged back to the System Fund over the life of the asset.</td>
<td>Recently we rolled out our new pioneering cloud-based Guest Reservation System, one of IHG Concerto’s comprehensive set of capabilities, which we developed with Amadeus.</td>
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